GREAT TRANSITION INITIATIVE
TOWARD A TRANSFORMATIVE VISION AND PRAXIS

December 2019

System Redesign Is Key

Contribution to GTI Forum Corporations in the Crosshairs

Duncan Austin

Allen White's paper provides a crisp assessment of what corporate social responsibility (CSR) has and has not achieved these past few decades. I wholeheartedly agree with his conclusion that we seem to be reaching the limits of a first "chapter" of CSR and must now "consider more holistic and fundamental solutions that transcend CSR's incrementalism."

As we do so, we must take care not to dismiss the first chapter as some sort of failure or to disparage with hindsight the efforts of CSR pioneers (Allen White doesn't do this, but it is worth emphasizing). The CSR movement has significantly raised awareness of sustainability issues in the private sector and helped accelerate research and innovation paths that will bear ongoing fruit in the coming years and decades. It has been an important phase in our ongoing collective learning process about how to become more sustainable.

However, it is equally important that we not succumb to the pull of emotional and professional "sunk costs" of established CSR models and instead muster the resolve to think boldly about what comes next.

In that spirit, and while in general agreement with the intentions of Allen White's paper, I will offer a view challenging his proposal. My main concern is that a notion of *corporate* redesign risks perpetuating efforts to change corporate purpose and behavior *unilaterally* without full regard to the *relationships* between corporations and other parts of the economic system, principally the financial and government sectors, which limit what corporations can achieve alone. It has been an understandable impulse to go after corporations in isolation, as they are the largest and most influential actors within the economic system and make for conspicuous and promising targets.

However, I believe we need to think beyond mere corporate change to a larger *system redesign* and work back from there to implications for corporations.

In particular, I will make two points. First, voluntary corporate efforts remain deeply vulnerable to the "profit enforcement" dynamic of financial markets, which dominates the relationship between investors and corporations. Second, to circumvent that problem requires changing corporate behavior via policy, but the current nature of the relationship between corporations and government thwarts such efforts. Hence, targeting the form of the *relationship* between corporations and government must now be a key focus for the sustainability movement.

Profit Enforcement Trumps Stakeholder Interests

Efforts at corporate redesign are motivated by a desire for companies to promote so-called "stakeholder interests" alongside "shareholder interests." The sheer fact that we must continue to make this terminological distinction means that it must be true that stakeholder interests conflict to some degree with shareholder interest to maximize profits *as otherwise there would no need to invoke a separate rubric*.

Unfortunately, because of this tension, efforts to expand corporate purpose—for nearly 100 years now—have repeatedly struggled against the "profit enforcement" nature of the public financial markets. The profit-enforcement dynamic arises as the unplanned outcome of tens of thousands of investment firms simply going about their business. The multitude of individual return-maximizing efforts of competitive and incentivized investors combines to ensure all the economy's tradable assets are inexorably driven towards their profit-maximizing use.

Public companies face this pressure daily. While there is certainly a growing number of long-term investors favorable to stakeholder interests, the presence of even a small number of short-term, or activist, investors is sufficient for "costly" stakeholder interests to be arbitraged away. These investors will be willing to pay more than others to gain control of the asset and then restore it to profit-maximizing potential. Even a small amount of this activity acts as a deterrent that keeps all public entities on their toes and directs them to "sweat their assets" preemptively.

Privately held companies are of course insulated from this pressure for as long as they wish to—or can—remain private. However, it is normally just a matter of time before a private asset comes up for sale and confronts the same dynamic that public companies face daily. It thus proves very difficult to bind companies voluntarily to pursue valued stakeholder interests not captured by current measures of profitability in any form that withstands a potential change of ownership.

Friedman’s Feedback Loop

In simple terms, the first chapter of CSR has largely been characterized by challenging Milton Friedman’s statement that the “social responsibility of corporations is to make a profit” and arguing that “no, in fact, the social responsibility of a corporation should be about more than profit maximization.” But this strategy has foundered on the rocks of financial market discipline.

The alternative, then, is to allow companies just to focus on profits but make sure that the measurement of profit is much more aligned to sustainability than it currently is. There are good reasons why “releasing” companies to focus solely on profit might make sense: they are well organized to do just this and, in aggregate, demonstrate considerable aptitude for the task!

But this second approach is currently confounded not by Friedman’s headline statement, but rather by the feedback loop that the statement conceals and that defines the relationship between corporations and policymakers.

In a political system where corporations are allowed to influence policymaking (e.g., via lobbying, financial support for candidates, etc.), the innocent-seeming contention that the “social responsibility of corporations is to make a profit” acts as a vehicle by which corporations are increasingly likely to define policies in their interest. If the expected return on expenditures committed to shaping regulations is greater than a company’s weighted average cost of capital, and if lobbying against regulations is permitted under what Friedman terms the “rules of the game,” then the notion that companies have a social responsibility to maximize profits equates to firms *having a social responsibility to resist any regulation that appears costly.*

In systems thinking terms, this is the existence of a *positive feedback loop* from the corporation to the policymaking arena, which permits—indeed, seemingly obliges—a portion of corporate profits to be reinvested back into shaping laws and rules to enable higher future profits, which in turn creates more funds to reinvest into shaping future laws, etc. One might call it Friedman's Feedback Loop.

Positive feedback loops in systems, if not sufficiently counterbalanced by negative feedback loops, generate runaway dynamics. This particular runaway dynamic has become sufficiently strong that it has induced a succession of regulatory and legal changes that has continually bolstered corporate influence over politics and so transformed a more balanced earlier form of capitalism into today's "runaway corporatism."

As this feedback loop has persisted, Friedman's statement has become increasingly tautological: what is profitable increasingly defines what is socially responsible. The meaning of "social responsibility" collapses from something that governments might define in the public interest into anything that increases corporate profits.

While this might just be viewed as the flexing of corporate muscle over socioeconomic arrangements, it received intellectual backing by influential mid-twentieth-century economic theories which argued that markets were *complete*, capturing all or nearly all of what humans valued. *If* this assumption were true, equating social responsibility with profitability would not be damaging, as markets would, by definition, cover stakeholder interests.

However, it is now becoming evident that the claims of a complete market were grossly overstated. In 2011, the monetary value of the "services" provided free by the Earth's ecosystem was estimated at $125 trillion, nearly twice the value of global GDP. This is not to mention similar estimates for many of the non-monetized social interactions that enhance human welfare. It is not that the market doesn't capture all things of value; it doesn't even capture most things of value. In this circumstance, for governments to favor corporate profits over public interest is to fuel the engine that drives the growth of market values to the detriment of non-market values, or stakeholder interests.

The structural weakness then is not at the corporate level or at the policy level, but in the *relationship* between corporation and government. What that implies is that we need more explicit separation of Commerce and State. Separation between spheres of human activity is commonplace throughout society: students are not allowed to mark their own term papers, football players not allowed to call the offside line, defendants not allowed to rule in their own cases, politicians not allowed to count ballots, etc. What makes all these activities work satisfactorily is a clear and beneficial relationship between the key parties.

Conclusion

Of course, trying to address this feedback loop all sounds highly impractical, not least in an era when the runaway dynamic has been running full tilt. But in the absence of pursuing this explicitly, there is a danger that we pursue individual elements of the socio-economic system where changes seem possible but may ultimately be less effective. If this really is to be a new chapter of CSR—and human sustainability increasingly demands as much—then the appropriate target must be at the level of the overall socioeconomic system and getting the relationships between the actors right. A "systems view" of the world, emerging in many fields, encourages us to think about the relationships between the parts and not just the parts themselves. Hence, a key new focus for CSR will be to repattern the relationships in our socio-economic system to more sustainable ends.

About the Author

Duncan Austin is an independent writer who has worked for twenty-five-years in environmental advocacy and sustainable investing.

About the Publication

Published by the Great Transition Initiative.

Cite as Duncan Austin, "System Redesign Is Key," contribution to GTI Forum "Corporations in the Crosshairs," *Great Transition Initiative* (December 2019), https://greattransition.org/gti-forum/csr-austin.

About the Great Transition Initiative

The Great Transition Initiative is an international collaboration for charting pathways to a planetary civilization rooted in solidarity, sustainability, and human well-being.

As an initiative for collectively understanding and shaping the global future, GTI welcomes diverse ideas. Thus, the opinions expressed in our publications do not necessarily reflect the views of GTI or the Tellus Institute.